



U.S. Department of Agriculture



Office of Inspector General
Midwest Region

Audit Report

Food and Nutrition Service Compliance with Improper Payments Reporting Requirements

Report No. 27601- 0032-Ch
September 2004



UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250



DATE: September 28, 2004

REPLY TO

ATTN. OF: 27601-0032-Ch

SUBJECT: Food and Nutrition Service Compliance with Improper Payment Reporting Requirements

TO: Roberto Salazar
Administrator
Food and Nutrition Service

ATTN: Lael Lubing
Director
Grants Management Division

This report presents the results of our audit of the Food and Nutrition Service's Compliance with Improper Payment Reporting Requirements. Your response to the draft report, dated August 27, 2004, is included in its entirety as exhibit A with excerpts and the Office of Inspector General's position incorporated into the relevant sections of the report.

Based on the information contained in the response, management decision has not been reached for any of the recommendations. Management decision can be reached when Food and Nutrition Service provides the additional information outlined in the OIG Position sections of Findings 1, 2, and 3 of the report.

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the corrective action taken or planned and the timeframes for implementation for Recommendations Nos. 1, 2, 3, 4, and 5. Please note that the regulation requires a management decision to be reached on all findings and recommendations within a maximum of 6 months from report issuance, and final action be taken within 1 year of each management decision.

/s/

ROBERT W. YOUNG

Assistant Inspector General
for Audit

Executive Summary

FNS Compliance with Improper Payment Reporting Requirements (Audit Report No. 27601-0032-Ch)

Results in Brief

This report presents the results of our audit of the Food and Nutrition Service's (FNS) compliance with improper payment reporting requirements. The purpose of this audit was to determine whether FNS was identifying and reporting the extent of improper payments in accordance with Office of Management and Budget (OMB) requirements for the Food Stamp Program (FSP), National School Lunch Program (NSLP), and the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC).

FNS will not be in a position to comply with the Improper Payments Information Act of 2002 (IPIA) and OMB guidance to estimate improper payments and report the same in the United States Department of Agriculture's (USDA) 2004 Performance and Accountability Report (PAR) for the NSLP, WIC Program or Child and Adult Care Food Program (CACFP). However, it is in compliance for the FSP and reported the required dollar estimate of improper payments. We found that FNS did not include improper payment estimates for the NSLP and WIC in the 2003 PAR. The 2003 PAR does note that in the NSLP, the risk of erroneous payments is a significant concern. FNS did report a dollar estimate of improper payments for the FSP. Additionally, FNS noted WIC participant certification error rates from 1988 and 1998 contracted studies in its fiscal year (FY) 2003 and 2004 budget requests and the 2003 PAR, but provided no dollar estimates. FNS officials stated that they believed that the error rate disclosed by the WIC studies were not sufficiently stable for a current national estimate of an improper payment rate. At the time of our audit, FNS had only begun to develop plans to estimate improper payments in the NSLP and had not determined an acceptable approach to address WIC and CACFP improper payments.

We believe that FNS could have used available information from numerous sources, such as OIG audits, FNS' contracted studies and internal reviews, to establish baseline information that could be used to establish error rates for both the NSLP and WIC in response to OMB's data requests for improper payments. For instance, FNS' 1999 analysis for 12 states showed that the NSLP error rate reached 20 percent. However, FNS had not used this data to help quantify improper payments. The NSLP funding was approximately \$1.3 billion for the States in the analysis for FY 2003. According to FNS, it's most recent study, completed in 2004, showed that over 18 percent of those certified for free meals were ineligible for those meals. Similarly, FNS did not use its most recent studies of the WIC program, which disclosed participant and vendor error rates that totaled 6.7 percent, to report improper payments for the 2003 PAR. The participant study noted that improper

payments totaled \$120 million based on certification error, and FNS estimated that improper payments for vendors would have ranged between \$58 and \$99 million.

According to FNS management, they are well versed in current requirements for improper payment reporting and very involved with interagency efforts to develop implementation policies and procedures. FNS officials stated that they were negotiating with OMB the use of existing management information as a basis for providing a measurement tool to document continued progress in reducing errors in the NSLP and WIC. OMB had recently requested a description of FNS efforts to establish baseline estimates for the NSLP and WIC, including what information has been collected, and what the timetable is for implementation.

FNS officials expressed the fundamental concern that they lacked statistically-valid nationwide estimates from currently available information for programs other than FSP. Our audit report does not state that FNS could develop statistically-valid estimates from existing information. But, we concluded that FNS possessed sufficient information to quantify the extent of improper payments as baseline estimates until statistically-valid estimates are developed. While not ideal, this would help meet the intent of the Improper Payments Information Act of 2002 (IPIA) and OMB guidance and may help in tracking progress in addressing the improper payment issues that are evident. Unless FNS develops procedures for quantifying improper payments in the future, the USDA PAR will continue to lack information required by law.

Recommendations In Brief

We recommend that FNS develop methodologies to quantify and report the extent of improper payments in the NSLP and WIC from available data until such time that statistically-valid estimates are available. In addition, FNS should develop and implement plans for reporting estimated improper payments for the NSLP and WIC in the USDA FY 2004 PAR and thereafter, including corrective actions taken and planned to reduce improper payments.

Agency Response

In its response to the official draft dated August 27, 2004, FNS officials disagreed with our recommendations. The officials stated that they had fundamental differences with OIG in the way we represented their efforts to curb improper payments and with the recommendations that FNS provide non-statistically-valid estimates of improper payments. They stated that FNS can only report statistically-valid estimates and to do otherwise would be contrary to OMB and the Chief Financial Officers (CFO) Council guidance. Their response is provided in its entirety as exhibit A of this report.

OIG Position

We do not agree with the FNS characterization of the report's recommendations as requiring action contrary to the IPIA, or to OMB and CFO Council guidance; by recommending that FNS develop methodologies to quantify and report the extent of improper payments in the NSLP and WIC from available data until such time as statistically-valid estimates are available. In their response, FNS officials state that OIG contends that without reporting dollar estimates of error, corrective actions cannot be pursued or will be ineffective. That is not correct. Rather, we contend that without any type of measurement of the extent of improper payments in the NSLP and WIC, the effectiveness of actions that have been or will be taken, cannot be determined.

FNS officials will not have a statistically-valid estimate of the NSLP until at least 2007, if at all, and they have not established a date for an estimate of WIC and CACFP improper payments.

The report notes that FNS has information that could be used to quantify their improper payments until statistically-based information become available. In the past, OMB has requested statistically-valid estimates of improper payments but has also requested information based on other methods as well. OMB has stated in Circular A-11, Section 57, that if the estimates are not based on a statistical projection to the universe, the agencies should provide a detailed description and assessment of the current methods for measuring the rate of erroneous payments and the quality of data resulting for these methods. We discussed this point with an official of the Office of Federal Financial Management, OMB, who stated that quantifying the extent of improper payments through contracted studies or other sources should have been done until statistically-valid information could be developed.

In their response to the audit, FNS officials noted they have had extensive discussions with OMB on their ability to provide a statistical measure of improper payments for their major programs (other than FSP) and have come to an understanding on how to proceed with alternative actions until a proper measure of improper payments can be provided. If these discussions lead to an alternative that meets the intent of the IPIA, these issues may be resolved.

Abbreviations Used in This Report

BDR	Budget Data Request
CACFP	Child and Adult Care Food Program
CFO	Chief Financial Officer
FMFIA	Federal Managers Financial Integrity Act of 1982
FNS	Food and Nutrition Service
FSP	Food Stamp Program
FY	Fiscal Year
GAO	General Accounting Office
IPIA	Improper Payments Information Act of 2002
MD&A	Management Discussion and Analysis
NSLP	National School Lunch Program
OIG	Office of Inspector General
OMB	Office of Management and Budget
PAR	Performance and Accountability Report
PMA	President's Management Agenda
TEFAP	Temporary Emergency Food Assistance Program
USDA	U.S. Department of Agriculture
WIC	Special Supplemental Nutrition Program for Women Infants and Children

Table of Contents

Executive Summary	i
Abbreviations Used in This Report.....	iv
Background and Objectives	1
Findings and Recommendations.....	3
Section 1. Improper Payments Reporting for the NSLP and WIC	3
Finding 1 FNS Did Not Develop Improper Payment Estimates for the NSLP	4
Recommendation No. 1.....	8
Recommendation No. 2.....	8
Finding 2 FNS Did Not Develop Improper Payment Estimates for WIC	9
Recommendation No. 3.....	11
Recommendation No. 4.....	12
Section 2. Improper Payments Reporting for All Other Programs	13
Finding 3 FNS Had No Plan to Report Estimates in the CACFP in FY 2004	13
Recommendation No. 5.....	14
Scope and Methodology.....	15
Exhibit A – Agency Response	16

Background and Objectives

Background

Improper and erroneous payments have been a significant, widespread, and longstanding problem in the Federal Government. As the General Accounting Office (GAO) has observed in several reports and testimony before Congress, the true extent of improper payments is not known because relatively few agencies have publicly reported them over the years. In a memorandum for the Secretary in September 2003, OIG also identified improper payments as one of the major management challenges within USDA.

According to OMB, improper payments are those that should not have been made or that were made for incorrect amounts—specifically, inadvertent errors such as duplicate payments and calculation errors, payments for unsupported or inadequately supported claims, payments for services not rendered or rendered to ineligible beneficiaries, and payments resulting from fraud and abuse. Improper payments may occur in programs administered directly by the Federal Government or in programs administered by a third party such as State or local governments.

The Improved Financial Performance section of the President's Management Agenda of 2002 (PMA) also emphasized the need to identify erroneous payments and to set goals to reduce those payments. In order to establish a baseline of improper payments across the Government, agencies were to include, beginning with their 2003 budget submissions, information on actual and target improper payment rates, where available, for benefit and assistance programs over \$2 billion. OMB's Circular A-11, Preparation and Submission of Budget Estimates for 2001 and 2002, Section 57, instructed agencies with specially identified programs to submit estimated improper payment data, assessments of agency efforts to minimize improper payments, and action plans to correct and prevent those payments with their initial budget submissions for FY 2003 and 2004. Circular A-11 specifically listed the FSP, NSLP, and WIC as programs for which USDA should report improper payment information.

In 2002, the President signed the Improper Payments Information Act (P.L. 107-300), which expanded the prior reporting requirements to include all programs that may have significant improper payments. OMB defined significant improper payments as those exceeding \$10 million and amounting to at least 2.5 percent of total program payments. In May 2003, OMB issued new guidance to agencies for estimating and reporting improper payments, including a provision that agencies base their estimates on valid statistical samples. Under the Act, agencies must report improper payment estimates in the Management Discussion and Analysis (MD&A) section of their FY 2004 PAR. Agencies with programs previously covered by

Circular A-11 were also required to report this information in the MD&A of their FY 2003 PAR.

FNS staff participates in an on-going joint workgroup composed of members of the Chief Financial Officers Council (CFOC) and the President's Council on Integrity and Efficiency (PCIE) to address the issue of improper payments. According to FNS officials, the group and its subcommittees convene regularly to develop best practices and other methods to reduce or eliminate improper payments made by Federal agencies, and issues reports and other materials reflecting the group's determinations.

For the purposes of this report, we consider erroneous payments and improper payments as synonymous terms.

Objectives

The objective of the audit was to determine whether FNS was identifying and reporting the extent of improper payments for the FSP, NSLP, and WIC in accordance with guidelines established by OMB, and to evaluate the agency's actions to limit improper payments for these programs.

Because OMB issued guidance for implementing the Improper Payments Information Act of 2002 during the course of our audit, we included the Act's requirements in our review of FNS actions.

Findings and Recommendations

Section 1. Improper Payments Reporting for the NSLP and WIC

As a part of the annual budget processes of FYs 2000, 2001, and 2002, OMB requested improper payment information for several FNS programs: the FSP, the NSLP, and WIC. FNS provided improper payment estimations (both rate and dollar estimates) for the FSP. FNS noted in its response to OMB Circular A-11 requirements, that studies and analyses had been conducted over more than 10 years for the NSLP and WIC. FNS reported a) that a past study of the NSLP had produced estimates of household error in the application process and b) that other sources such as national survey data had been used to explore application error. FNS did not quantify this information in terms of rates of error or dollars when reporting to OMB. FNS did provide OMB with quantifying data from several WIC studies regarding participant and vendor error. According to FNS, prior to the passage of the Improper Payments Information Act, these were provided as an illustration of the relatively low level of participant and vendor error and were not intended to serve as documentation of errors leading to improper payments. FNS also reported to OMB what they perceived as data limitations that prevented using the information to estimate program-wide erroneous payments. Although FNS responded to OMB's initial BDR in June 2000¹ with specific improper payment estimates for the FSP, the agency did not provide improper payment estimates for the NSLP or WIC. In its budget estimates for 2003 and 2004, FNS again provided specific FSP improper payment estimates but did not include improper payment estimates for the NSLP and WIC. It was also noted that the agency's 2003 PAR did not reflect improper payment estimates for the NSLP and WIC and, at the time of audit fieldwork, no formal plans existed that would result in meeting requirements for FY 2004 PAR reporting. At the audit exit conference, we were informed by FNS that the agency was in negotiations with OMB to obtain approval for implementation plans to address NSLP and WIC.

For more than 10 years, FNS knew through OIG and GAO audits, FNS-contracted studies and internal analyses that vulnerabilities existed in the NSLP and WIC and had taken some actions to obviate them. But the agency had not developed processes to estimate the amount of improper payments associated with these programs and to gauge the effect of the additional controls. FNS officials stated that, prior to the passage of the IPIA, its examination of the NSLP focused on certification accuracy as an indicator of the risk of improper payments and, with limited research dollars and no mandate to produce an estimate of improper payments, it was decided to focus on raising awareness of certification accuracy and ways to prevent or

¹ OMB Budget Data Request No. 00-46, dated May 15, 2000.

reduce inaccuracies, rather than determining a reliable estimate of payment error nationwide. Additionally, until the IPIA and OMB guidance were issued, FNS believed the incidence and amount of errors in the WIC program were relatively limited. We believe that FNS could have fulfilled OMB's instructions for the 2003 PAR using appropriately qualified information already available until better information was determined. We obtained evidence from various sources, dating back to 1988 for WIC and 1990 for the NSLP, which showed improper payments to WIC and NSLP participants. FNS' position was that using existing non-statistical data was contrary to the IPIA and OMB guidance that requires using statistically-valid samples. They believed such information could have immediate and significant negative ramifications for program policy and oversight. However, the IPIA does not specify statistically-valid estimates, but requires that estimates be reported for programs determined to be susceptible to significant improper payments. While statistically-valid estimates would be best, and are called for in the OMB guidance, they are not available. FNS has recently initiated contracting efforts to develop a statistically-valid estimate of improper payments for the NSLP but projects that results will not be available until 2007. We believe FNS should report improper payment estimates for the NSLP and WIC based on existing information, qualified as appropriate, until such time in the future that statistically-valid estimates are determined and assess the impact corrective measures taken have had on improper payments.

Finding 1

FNS Did Not Develop Improper Payment Estimates for the NSLP

FNS recognized that the NSLP was a program susceptible to significant improper payments. In fact, it identified the integrity of household eligibility within the program as a material deficiency in its Federal Managers' Financial Integrity Act Report (FMFIA) beginning with the report for FY 1999. However, FNS had not provided an improper payment rate or dollar amount to OMB to define the extent of the problem. We believe that FNS could have submitted appropriately qualified estimates of improper payments to OMB by using available data as risk assessments—specifically, school food authority verification results, contract studies, OIG audits, and internal analyses which consistently document an error rate of about 20 percent.

In response to OMB's original BDR for improper payment estimates in May 2000, FNS reported that the nature of NSLP payment errors and the difficulties in capturing all variables involved—which included certification, participant, and operational errors at the State and local levels—prevented it from providing a reasonable and statistically-valid estimate.

Through Section 57 of Circular A-11, OMB requested improper payment estimates for FYs 2001 and 2002 budget requests. In both years, FNS

responded that it did not have reliable data or methodology for an improper payment rate or dollar amount in the NSLP. The Agency did provide OMB with the analyses and descriptions requested but without any quantifying data to gauge the potential extent of the problem.

In its discussions with OIG during the course of the audit, FNS agreed that NSLP certification was a problem area and reaffirmed that previous Agency analysis was not conducted to define the extent of improper payments. While data was available from numerous sources, FNS stated that the information was sometimes outdated, not statistically-valid when applied nationwide, and only addressed erroneous certification or a risk of erroneous payment rather than measuring the level of erroneous participation and related payments. However, we believe that FNS could have used existing data from numerous sources to develop a baseline of improper payments for the 2003 PAR. For example, the 1999 Current Population Survey for participation and income estimated that 24 percent of certified children were not eligible for free or reduced price lunches. However, this analysis did not develop a dollar impact related to ineligible certifications. In addition, we obtained other information that illustrated significant error rates over the course of 10 years:

- A 1990 FNS-contracted study, Income Verification in the National School Lunch Program, reported a nationally representative error rate as detected by current school district verification procedures of 11.1 percent due to detected errors and an additional 10.1 error rate because of the failure of participants to respond to verification efforts. Thus, according to the study, the nationally projected total error rate was reported as 21.2 percent.
- A 1991 OIG survey of 20 large school food authorities in the Midwest region disclosed that 31 percent of applications contained inaccurate or incomplete household income information.
- A 1997 OIG audit, Verification of NSLP Applications in Illinois, disclosed that 19 percent of applicants reported incorrect income or did not respond to requests for income information. This resulted in estimated improper payments of \$31 million per year.
- A later 1999 FNS internal analysis of NSLP application verification results for 12 States and a regional office-administered program disclosed an error rate of 26 percent.

Recognizing that none of the above information was designed to provide a statistically-valid nationwide erroneous payments estimate, we believe that FNS could have used the information with appropriate qualifications, as a

baseline against which to measure future statistical estimates of improper payments. As a possible starting point for establishing a baseline error rate, we selected the above FNS internal analysis, which showed a 26-percent error rate (where applicants' eligibility status changed, e.g. from free to paid, paid to reduced-price.) FNS stated that 26 percent was not the actual error rate because non-respondents accounted for 40 percent of the changes, and about half of those would remain eligible in their current status. Taking this into consideration, the error rate would remain high at 20.8 percent.² FNS has reported cash payments to these States totaling about \$1.3 billion for FY 2003. We believe that a dollar estimate of improper payments could have been calculated and used as a baseline until better information was available. While not ideal, this could help meet the intent of the IPIA and OMB guidance and may help in tracking progress in addressing the improper payment issues that are evident in this program. This was also needed as part of the risk assessment process to determine if the extent of improper payments exceeded the OMB thresholds.

FNS stated that calculating improper payments based on certification errors was not a valid measurement because certification errors do not necessarily correlate one-to-one to program dollars. For example, all children certified for free and reduced-price meals do not always eat a meal every day. Therefore, if a child was found ineligible but had not received meals for each day of ineligibility, there would not be a dollar loss to the program for those days. In addition, FNS stated that a portion of the applicants that do not respond to verification efforts are actually eligible. They also stated that requiring schools to identify and track free, reduced-price, and paid meals received by children on an individual basis, as well as to make multiple contacts with non-responsive applicants during verification efforts, could severely burden the schools' limited resources or not be cost effective. However, FNS procedures require schools to deny free/reduced-priced lunches to children when parents do not respond to the income verification request.

According to FNS officials, in 1997 FNS began to analyze national NSLP data trends and uses and reported the results to OMB in 1999. The report suggested significant problems in the NSLP. FNS discussed these problems with State Directors and school food associations. Subsequently, the Agency began several pilot projects to study alternative eligibility determination procedures. While these studies were ongoing, FNS officials stated they continued to have discussions with Congressional committees, the Administration, and State Directors on how to address verification issues in the NSLP.

² 26% x 40% x 50% = 5.2% representing those that did not respond but who may have been eligible for the Program benefits received. Thus, the 26% would be reduced by 5.2% to 20.8%.

In August 2002, FNS published proposed requirements for reporting and recordkeeping related to verification of applications. The rule, published as final on September 11, 2003, requires States to report verification efforts of their school food authorities to FNS. Prior audit work had recommended this action and now that it has occurred, we believe it should help to identify the extent of, and help to reduce, erroneous payments, provided that FNS monitors and evaluates the impact the action has. The first year of reporting, school year 2004-2005, would be voluntary, meaning that the results from all States would not be available until FY 2006 or later. Furthermore, FNS intended to use the results to analyze the certification process and develop corrective actions, not to assist in establishing improper payment estimates. We believe this information could be used to quantify the extent of improper payments.

Because FNS did not have a method to statistically estimate improper payments, FNS stated that they requested and, with OMB assistance, Congress approved \$5 million in FY 2004 to be used in large part to conduct a study aimed at providing a reliable, national estimate of over and under payments in the NSLP and School Breakfast Program (SBP). According to FNS, this large-scale study will also develop simulation models for generating annual national estimates of improper payments in the NSLP and SBP. FNS officials stated they are in the process of soliciting bidders to conduct this study. Due to the size and scope of this study, they estimate the study will take 2-3 years to complete. Even if the study is completed within the 3-year period envisioned, FNS will report no estimates of improper payments to Congress and the public, statistically valid or otherwise, until at least FY 2007. However, this should provide FNS with the framework needed to comply with the IPIA.

According to FNS officials, senior FNS and OMB officials have met on a number of occasions to discuss IPIA compliance requirements. They stated that OMB officials have acknowledged that full compliance with the IPIA was not practicable in the short-term, given the resources and actions required. Officials discussed strategies for coming into compliance, and OMB and FNS are working together on a long-term plan.

We concluded that FNS could have used the available information as a risk assessment, confirming that the NSLP was susceptible to significant improper payments, and enabling management to estimate the level of improper payments and develop corrective actions. While this is not ideal, this could help meet the intent of the IPIA and OMB guidance and may help in tracking progress in addressing the improper payment issues that we believe are very evident in this program. We also believe that information obtained from the above September 2003 rule could be used to assess the effectiveness of corrective actions to reduce the improper payments.

Recommendation No. 1

Use available data to quantify the extent of improper payments in the NSLP and for use as a baseline against which to measure the impact of corrective measures until such time that statistically-valid estimates are determined.

Agency Response.

In its response dated August 27, 2004, FNS officials stated that they could report only statistically-valid estimates of improper payments in accordance with OMB guidance and the IPIA. FNS officials also stated that they have had extensive discussions with OMB regarding their ability to provide a statistical measure of improper payments for major programs, other than the FSP, and on how to proceed with alternative actions until a proper measure of improper payments can be provided.

OIG Position.

While we agree that statistically-valid estimates of improper payments would be best, FNS has stated that they cannot report such estimates for the NSLP until at least 2007. As noted in this finding, FNS has data from numerous sources that could be used as baseline information to quantify the extent of improper payments in the NSLP, until statistically-valid estimates are available. We continue to believe that FNS should use existing data, qualified as necessary, to quantify improper payments in the NSLP. This could involve using the verification results to be reported in response to the rule FNS published in September 2003, that requires States to annually report the results of verification efforts by their school food authorities to FNS. These results could be used to monitor the effect of corrective actions taken until statistically-valid estimates are available. To reach management decision, FNS needs to quantify the extent of improper payments using existing data.

Recommendation No. 2

Develop and implement plans to statistically estimate the amount of improper payments as required by the IPIA in the NSLP for reporting in the FY 2004 PAR and thereafter. In addition, develop and implement plans to formulate corrective actions to reduce the extent of improper payments and gauge the success of those actions.

Agency Response.

In its response, FNS officials stated that they have only recently received funding from OMB and Congress to conduct a study they expect will provide a statistically-valid estimate of improper payments for the NSLP.

OIG Position.

As noted in the report, FNS estimated that the study aimed at providing a reliable, national estimate of improper payments in the NSLP and SBP will take 2-3 years to complete. FNS will report no results to Congress and the public until FY 2007. To reach management decision, FNS needs to provide OIG with a schedule of milestone dates/time-phased benchmarks established to complete the study and report the results.

Finding 2

FNS Did Not Develop Improper Payment Estimates for WIC

In response to OMB requests for information, FNS did not report WIC as susceptible to significant improper payments, despite 1998 studies that indicated a 4.5 percent certification error rate and a 2.2 percent vendor error rate for the \$4 billion program. FNS had not established a baseline estimated error rate for FY 2003. However, FNS has reevaluated its position because of the IPIA and subsequent OMB and OCFO guidance, to consider WIC as a program susceptible to improper payments. But, FNS will not be able to present improper payment estimates for WIC in the FY 2004 PAR as required by OMB and the IPIA, nor will it be able to gauge the impact of current efforts to reduce improper payments. Furthermore, FNS had not developed a system to estimate improper payments in the future.

In response to OMB's original BDR for improper payment information in May 2000, FNS did not account for WIC.

Through Section 57 of Circular A-11, OMB requested improper payment estimates for FYs 2001 and 2002 budget requests.

- The FY 2001 instructions stated that agencies should provide data on all direct and indirect programs where erroneous payment rates were currently being estimated. For other programs where erroneous payment rates were not currently estimated, agencies were instructed to submit an analysis and description of whether and how improper payments could be estimated.
- The FY 2002 instructions also asked for data on programs for which improper payment estimates had been developed. In addition, for all

programs listed in exhibit 57B, the instructions asked for the status of action plans for conducting risk assessments or developing estimates for erroneous payments and for the status of action plans for preventing/reducing improper payments.

FNS officials stated that in both years, FNS did not develop or report improper payment estimates for WIC because the incidence and amount of overpayments were believed to be very reasonable for the program. However, with the passage of the IPIA and the issuance of OMB and OCFO guidance, FNS officials stated that they realized they needed to reevaluate the issue of improper payments in WIC.

FNS contracted studies for FY 1998 showed participant error rates of 4.5 percent and vendor error rates of 2.2 percent. FNS officials believe the error rates disclosed by these studies were not acceptable and stable for estimating a nationwide improper payment rate because the studies were performed prior to significant regulatory change regarding the overall certification process and therefore the given estimate was believed to be a likely overstatement of the problem. As a result, FNS has not quantified the extent of improper payments in WIC and therefore was not able to determine if the newly implemented controls were effective.

We obtained and reviewed the Final Report for FNS' contracted study, National Survey of WIC Participants 1998³. The report, issued October 2001, provided national estimates of the case error rate and dollar error within the WIC program. Based on total food costs of over \$2.6 billion and the estimated 4.5-percent participant error rate, the study reported improper payments totaling \$120 million. FNS did not report this estimate in response to Circular A-11⁴ because officials stated that the amounts of improper payments for WIC were reasonable and implementing new program regulations would reduce the error rate even further. Specifically, in 1998 FNS implemented up-front verification, requiring participants to present documentation of income during the WIC certification process. However, the results from this study exceeded the 2.5% and \$10 million threshold that OMB established as significant and FNS could have reported this in the 2003 PAR. We believe that the implementation of up-front verification would likely contribute to a reduction in improper payments but FNS must monitor its use to ensure it has that positive impact. This was also needed as part of the risk assessment process to determine if the extent of improper payments exceeded the OMB thresholds.

FNS further explained that it did not report the 1998 study's estimate to OMB because certification errors do not translate into participation, which is

³ Report No. WIC-01-NSWP, National Survey of WIC Participants, Final Report, October 2001.

⁴ Circular A-11, Preparation, Submission, and Execution of the Budget, section 57.

necessary for payment error. FNS considered improper payment estimates based on certification errors unreliable due to the discrepancy between WIC enrollment and participation. For example, participants did not always pick up their food coupons or use all of them each month. However, the study's results were adjusted to reflect the ratio of participants to enrollees. FNS also noted that the estimate of participant error in the 1998 study considered income only, although nutritional risk was also required to be eligible for WIC. In our opinion, this is not relevant because nutritional risk is considered only if the participant meets income eligibility; therefore the 4.5-percent error rate found in the 1998 study would be a minimum error rate figure.

We also reviewed another 1998 study commissioned by FNS and issued in 2001, which revealed improper payments to WIC vendors at an estimated error rate of 1.3%. Additionally, an FNS internal analysis in May 2003 based on FY 2001 retail redemptions estimated total over- and undercharges of 2.2%, totaling between \$58 and \$99 million. According to FNS, these error rates were reasonable. The agency had also issued a final regulation for food delivery systems in December 2000 that officials believed would improve control over abusive vendors. We agree that the implementation of this regulation, and the attendant controls, long sought by OIG, will likely reduce improper payments to WIC vendors. However, at the time of our audit, 12 States still had not fully implemented the regulation, and FNS had not evaluated the new controls to determine their impact on the program.

With the issuance of OCFO guidance that responded to IPIA requirements, FNS reported to OCFO that WIC met the threshold established by OMB guidance as susceptible to significant improper payments. But the Agency had not established a timeframe for a statistical estimate of improper payments as required by the IPIA. According to FNS officials, FNS plans to contract for a follow-up study to determine a nationwide error rate in the WIC program. However, this study, without additional resources, will not develop a methodology to estimate improper payments on an annual basis.

Although FNS had implemented certification and vendor controls recently, without a baseline estimate of improper payments from which to measure annual estimates, FNS cannot evaluate whether the controls are working as intended. The Agency is working with OMB to determine how it should come into compliance with the IPIA.

Recommendation No. 3

Use available data to quantify the extent of improper payments for WIC and for use as a baseline against which to measure the impact of corrective measures until such time that statistically-valid estimates are determined.

Agency Response.

In its response, FNS officials stated that they could report only statistically-valid estimates of improper payments in accordance with OMB guidance and the IPIA. FNS officials also stated that they have had extensive discussions with OMB regarding their ability to provide a statistical measure of improper payments for major programs, other than the FSP, and on how to proceed with alternative actions until a proper measure of improper payments can be provided.

OIG Position.

We continue to believe that FNS should use existing data to quantify the extent of improper payments. Until such time as statistically-valid estimates are available, FNS could use their management evaluation process to assess the effectiveness of corrective actions. To reach management decision, FNS needs to quantify the extent of improper payments using existing data.

Recommendation No. 4

Develop and implement plans to statistically estimate the amount of improper payments as required in the IPIA in WIC for reporting in the FY 2004 PAR and thereafter. In addition, develop and implement plans to formulate corrective actions to reduce the extent of improper payments and gauge the success of those actions.

Agency Response.

In its response, FNS officials did not directly address efforts to develop statistically-valid estimates of improper payments in WIC but the response did state that FNS has had extensive discussions with OMB on FNS's ability to provide a statistical measure of improper payments for major programs other than the FSP. The response also noted that FNS officials believe they have come to an understanding with OMB on how to proceed with alternative actions until a proper measure of improper payments can be provided.

OIG Position.

To reach management decision, FNS needs to develop statistically-valid estimates of improper payments for WIC and needs to provide OIG with a time-phased schedule established to do so and to report the results to Congress and the public.

Section 2. Improper Payments Reporting for All Other Programs

Although FNS had been asked to provide improper payment information for its largest programs for several years, it was not required to assess improper payments in the rest of its programs until the passage of the IPIA in 2002. In addition to the FSP, NSLP, and WIC, the IPIA now requires FNS to annually review all of its programs and activities to identify those that may be susceptible to significant improper payments. Beginning with the FY 2004 PAR, FNS must report estimates of improper payments and describe its efforts to reduce them in those programs and activities.

Finding 3

FNS Had No Plan to Report Estimates in the CACFP in FY 2004

Although FNS officials have reviewed all of its programs and identified the CACFP as a program susceptible to significant improper payments, they have not developed a methodology to estimate annual amounts of improper payments or action plans to reduce improper payments for this program. As a result, FNS will not be able to report improper payment estimates in the FY 2004 PAR or show the results of its efforts to reduce improper payments in the CACFP.

That program is of particular concern because OIG audits have identified it as susceptible to extensive improper payments. OIG work in Operation Kiddie Care in 1999 disclosed that 37 seriously deficient sponsors in 23 States received about \$76 million annually in food and administrative funds. Six other audits completed between 1998 and 2002 identified deficiencies in the CACFP totaling over \$37 million.

At the exit conference, FNS officials stated that they have completed a review of all programs (other than the FSP, NSLP, and WIC) and identified the CACFP as being susceptible to improper payments. However, they explained that the resources needed to develop estimates for the CACFP would be much greater than those needed for the NSLP and they did not receive additional funding for such a complex and expensive mandate, except for the NSLP.

FNS has no plan to establish a statistical estimate of improper payments as required. We did not evaluate the assessment done by FNS of the other programs but, based on previous audit work, would agree with the FNS designation regarding CACFP. We would also agree with FNS that developing a statistically-valid estimate of improper payments for the CACFP would be a complex and difficult endeavor. OMB has recently met with FNS officials and requested information regarding current efforts to

establish baseline error rates, with timeframes, for the CACFP, WIC and NSLP, and what resources are required to develop credible estimates that comply with the IPFA. In the interim, FNS is working with OMB to develop a plan to report interim data as a way to measure improper payment efforts.

Recommendation No. 5

Develop and implement plans to statistically estimate and report the amount of improper payments as required by the IPFA for the CACFP. Develop and implement plans to formulate corrective actions to reduce the extent of improper payments and gauge the success of those actions.

Agency Response.

In its response, FNS officials stated that they have not received funding to perform statistically-valid estimates of improper payments in CACFP. In addition, the response stated that FNS has had extensive discussions with OMB on FNS's ability to provide a statistical measure of improper payments for major programs other than the FSP.

OIG Position.

To reach management decision, FNS needs to develop statistically-valid estimates of improper payments for CACFP and needs to provide OIG with a time-phased schedule established to do so and to report the results to Congress and the public. Until such time as statistically-valid estimates are available, they could use their management evaluation process to assess the effectiveness of corrective actions.

Scope and Methodology

We performed an audit of FNS compliance with improper payment reporting requirements at FNS headquarters in Alexandria, VA. We reviewed audit reports, contracted studies, and analyses from FY 1991 through FY 2003. However, the actual audit focuses on FY 2003 and FY 2004 reporting requirements for improper payments. We conducted our fieldwork from June through October 2003.

To determine when and how FNS reported to OMB its estimates for improper payments in the NSLP, FSP, and WIC, we gathered and reviewed studies, reports, and analyses by FNS. In addition, since no written plan existed, we conducted various interviews and participated in discussions with FNS officials to determine what actions were being taken to reduce improper payments.

To accomplish our audit objectives, we performed the following audit steps and procedures:

- We reviewed regulations, policies and procedures governing OMB's requirements for reporting and estimating improper payments, including Circular A-11, section 57 and Public Law 107-300.
- We reviewed budget estimates for FY 2003 and 2004 and the budget summary for FY 1998.
- We reviewed the FY 2002 PAR and the FY 2004 Annual Performance Plan.
- We interviewed FNS officials to determine the controls and procedures used to estimate improper payments.
- We interviewed OMB officials to determine what FNS had reported to OMB.
- We obtained pertinent information from GAO and OIG audit reports.

This audit was performed in accordance with generally accepted Government auditing standards.



United States
Department of
Agriculture

AUG 27 2004

Food and Nutrition
Service

3101 Park Center Dr.

Alexandria, VA 22302

SUBJECT: Audit Report No. 27601-0032-Ch
Food and Nutrition Service (FNS), Compliance with Improper
Payments Reporting Requirements

TO: Robert Young
Assistant Inspector General for Audit
Office of the Inspector General (OIG)

Thank you for the opportunity to comment on the subject Office of Inspector General (OIG) draft report. We are pleased that the current draft has taken many of our observations into consideration and appreciate that you allowed significant additional time for that consideration. However, we remain concerned over fundamental differences between OIG and Food and Nutrition Service (FNS) in two areas:

- The degree of this Agency's efforts to curb improper payments in these programs, and
- The representation of those efforts in meeting the requirements of the Improper Payments Information Act (IPIA) of 2002 and information requests from the Office of Management and Budget (OMB) that preceded the Act. Specifically, the OIG's recommendations that FNS provide non-statistically valid estimates of improper payments. FNS can only report statistically valid estimates.

FNS has attacked improper payments more zealously than any other Federal agency. FNS has also asked for funding to develop statistically valid estimates, where applicable. Under the leadership of Under Secretary Bost and working with Congress we have addressed improper payments to the maximum extent possible without impacting access to our nutrition programs by intended recipients. The Administration had made strong program reauthorization recommendations to reduce improper payments. The Congress chose to make more moderate efforts. Further, the Administration requested through the appropriation process additional resources to tackle improper payments but the Congress chose not to support these proposals and, in fact, reduced FNS' resources.

FNS cannot provide non-statistical valid estimates in accordance with OMB guidance, the IPIA, and Chief Financial Officers' (CFO) Council guidance with support from the President's Council on Integrity and Efficiency (PCIE). Estimates must be statistically valid to be trackable from year to year; to do otherwise would yield an unusable number.

We agree that FNS will not report a statistically valid, national measure of improper payments in either the National School Lunch Program (NSLP) or the WIC Program in FY 2004. However, while OIG has made the subject of this report the inability of the agency to come up with a measure of Program dollars lost to improper payments, the report still does not adequately inform the reader of all of the steps that the Agency has

taken to reduce the incidence of program error. OIG contends that without reporting dollar estimates of error, corrective action cannot be pursued or will be ineffective. The source of OIG's conclusions on the role dollar estimates play in managing improper payments is not clear. Neither the IPIA nor its implementing guidance argues that reporting a dollar estimate of improper payments is essential for developing and implementing corrective action on erroneous payments. A paper referenced in the OMB's IPIA guidance and prepared by the joint CFO Council and PCIE Workgroup explains that the reporting of improper payments "would allow greater oversight, provide management with a measure of progress, and assist in identifying whether further actions are needed."¹ We agree with this analysis, and support fulfilling IPIA requirements as soon as possible. Given the complexities of that task, neither OIG nor FNS have identified a way to do so without a costly investment in developing an estimation methodology and data collection. OMB concurs with this.

However, despite this, FNS did not wait to pursue corrective action on the completion of such estimates. The Agency has already acted on risk assessments for NSLP, WIC, and Child and Adult Care Food Program (CACFP) with extensive efforts to develop, test, and implement policy and management-related corrective actions, including some recommended by OIG in past years. These facts are not fully explained in the report and the report recommendations incorrectly suggest that corrective actions to address factors affecting improper payments have not been developed or pursued.

FNS determined in the 1990's that NSLP represented a significant risk for errors in eligibility determinations and began to develop corrective action for State agencies. A measure of NSLP certification error – which, significantly, was later shown to be flawed in estimating magnitude, but nonetheless *indicative* of a problem – was included in the FNS and USDA strategic plans for 2000-2005. A range of corrective actions were set in motion. A list of these actions has been provided to OIG. The audit provides only a perfunctory description of these actions.

For more than a year we have had extensive conversations with OMB on FNS's ability to provide a statistical measure of improper payments for major programs other than the Food Stamp Program. We believe that we have come to an understanding with OMB on how to proceed with alternative actions until a proper measure of improper payments can be provided. As you know, FNS has only recently received the funding from OMB and Congress necessary to conduct the study that we expect will provide a statistically valid estimate of improper payments for the NSLP. It has never received funding for an estimate for CACFP – a costly and complex enterprise.


In summary, we believe that this report does not accurately represent FNS's efforts to address improper payments issues with regard to Federal nutrition assistance programs. Additionally, this report recommends that we take an action contrary to OMB and CFO

¹ CFOC-PCIE, "Improper and Erroneous Payments in Federal Programs: A Framework for Action," available on the web at <http://www.cfoc.gov/documents/EIP%20Posn.Paper%2011-02.doc>. (Cited in OMB guidance on implementing Improper Payments Information Act of 2002: Public Law No: 107-300, available at <http://www.whitehouse.gov/omb/memoranda/m03-13-attach.pdf>.)

Exhibit A – Agency Response

Page 3 of 3

Council guidance. FNS remains committed to reduce and prevent the loss and waste that result from program error and making the best use of the resources available to meet the requirements of IPLA.

A handwritten signature in black ink, appearing to read 'Roberto Salazar', with a long horizontal line extending to the right.

Roberto Salazar
Administrator

Informational copies of the have been distributed to:

Administrator, FNS Attn: Agency Liaison Officer,	8
Office of the Chief Financial Officer Director, Planning and Accountability Division	1
General Accountability Office	1
Office of Management and Budget Natural Resources Division, Agriculture Branch	1